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No. 90-84

In the Supreme Court of the United States

OCTOBER TERM, 1990

EDUCATION ASSISTANCE CORPORATION, PETITIONER

v.

LAURO F. CAVAZOS, SECRETARY OF EDUCATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

Section 3001 of the Omnibus Budget Reconciliation Act of 1987 (OBRA), 20 U.S.C. 1072(e) (repealed), amended provisions of the Guaranteed Student Loan Program (GSLP) created by the Higher Education Act of 1965. Section 3001 required agencies that guarantee GSLP loans to transfer "excess" GSLP cash from their reserve funds to the Secretary of Education, for deposit into the general GSLP fund maintained by the Secretary for reimbursement purposes. Section 3001 also made the guaranty agencies' right to receive federal reimbursement for losses subject to their compliance with the transfer requirement. Section 3001 has been challenged on the ground that it violates the Takings and Due Process Clauses of the Fifth Amendments. The questions presented are:

1. Whether the guaranty agencies had "private property" rights to the excess cash within the meaning of the Takings Clause.

2. Whether Section 3001 "took" or abrogated the guaranty agencies' "vested right" to reimbursement under pre-OBRA contracts between the agencies and the Secretary.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-25a) is reported at 902 F.2d 617. The district court opinion (Pet. App. 27a-47a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on April 10, 1990. The petition for a writ of certiorari was filed on July 9, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. The Higher Education Act of 1965 (the Act), 20 U.S.C. 1071, established the Guaranteed Student Loan Program (GSLP). In that program, public and private lending institutions make low-interest, higher-education loans, subsidized by the federal government, to students. State and nonprofit private agencies that participate in the GSLP must execute an "insurance program agreement" with the Secretary in which the agencies promise to operate a student loan insurance program that meets GSLP requirements and to guarantee lenders they will pay 100% of the unpaid principal on a qualifying student loan in case of default or other failure to repay. 20 U.S.C. 1078(b); 34 C.F.R. 682.410, 682.411. The agreements specify that the state agency agrees to be bound by "all changes in the Act or Regulations in accordance with their respective effective dates," Pet. App. 3a, and the regulations similarly provide that "[a]ll of the agreements are subject to subsequent changes in the Act or the regulations that apply to the GSLP * * *." 34 C.F.R. 682.400(d). In return, the Secretary agrees to make interest subsidy payments, on behalf of students, to lenders whose loans are guaranteed by the agency. Pet. App. 2a-3a. The Act authorizes the Secretary to pay "special allowances" to the lenders, so that their return is not "less than equitable." 20 U.S.C. 1087-1(a).

The Higher Education Act of 1965 also authorizes the Secretary to enter into a "guaranty agreement" with a participating state guaranty agency in which the Secretary agrees to reimburse the state guaranty agency for losses resulting from the default of a student borrower on the unpaid balance of the principal and accrued interest on any GSLP loan. 20 U.S.C. 1078(c)(1)(A).[1] The amount of re-

[1] Before 1976, guaranty agencies were required to insure only 80% of the principal amount of covered loans, and the Commissioner of

imbursement ranges between 80% and 100% of the amount expended by the agency in discharge of its guaranty obligations, depending on the agency's overall default rate. Since 1986 guaranty agencies have been required to pay a reinsurance fee to the Secretary, equal either to 0.25% of the total principal amount of covered loans guaranteed by the agency that year, or 0.5% if the agency's overall default rate exceeded 5%. 20 U.S.C. 1078(c)(9).

As amended in 1986, the Higher Education Act of 1965 states that a participating state guaranty agency is "deemed to have a contractual right against the United States" during the life of each GSLP loan "to receive reimbursement" according to the provisions of that Act. Higher Education Amendments of 1986, Pub. L. No. 99-498, 100 Stat. 1381 (codified at 20 U.S.C. 1078(c)(1)(A)). The guaranty agreement, however, like the insurance program agreement, obliges each state guaranty agency to comply with "all changes in the Act or Regula-

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Education was authorized to enter into "reinsurance agreement[s]" with them in which the Commissioner would undertake to reimburse 80% of the agencies' guaranty losses. See 34 C.F.R. 682.404(a)(1). Under the Higher Education Amendments of 1976, Pub. L. No. 94-482, 90 Stat. 2114, 2120, the Commissioner was authorized to enter into "supplemental reinsurance agreements" with agencies that insured 100% of their covered loans, in which the Commissioner would undertake to reimburse 100% of their guaranty losses if they had an overall default rate below 5% of the principal amount of all loans; 90% if the default rate was between 5% and 9%; and 80% if the default rate exceeded 9%. See 34, C.F.R. 682.405. Under the Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1371, all guaranty agencies must insure 100% of their covered loans, and the reimbursement rate is the same as the Commissioner undertook in the supplemental reinsurance agreements. Since 1986 the "reinsurance" and "supplemental reinsurance" agreements have been referred to collectively as "guaranty agreements."

tions in accordance with their effective dates." C.A. App. 21, 25-26. The guaranty agreement also provides that the Secretary may withhold or demand compensation for federal payments – including reimbursements – if the state guaranty agency fails to comply with the Act or its implementing regulations. *Id.* at 23, 28.

The Higher Education Act of 1965 authorizes or provides for other sources of revenue to state guaranty agencies. It authorizes the Secretary to make cash advances to help establish or strengthen such agencies, 20 U.S.C. 1072(a)(1); it permits such agencies to collect a single insurance premium from lenders of not more than 3% of the principal amount of a loan, 20 U.S.C. 1078(b)(1)(H); it permits such agencies to retain 30% of amounts they collect from defaulting borrowers after reinsurance payments have been made to them, 20 U.S.C. 1078(c)(2)(D) and (c)(6)(A)(ii);[2] and it directs the Secretary to pay (and provides that guaranty agencies shall "be deemed to have a contractual right against the United States to receive") a portion of the agencies' administrative costs, 20 U.S.C. 1078(f)(1)(A) and (B).

Under the Secretary's regulations, state guaranty agencies must deposit reimbursements, revenue authorized or provided by the Act, and all state appropriations, gifts, grants, and investment earnings, into a "reserve fund." 34 C.F.R. 682.410(a)(1). The regulations stipulate that none of the money in the reserve fund may be used for purposes other than GSLP purposes specified by the Secretary: namely, guaranteeing loans, paying claims, refunding

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[2] Under 20 U.S.C. 1078(c)(8), a state guaranty agency must assign to the Secretary any loan for which the Secretary has made a reimbursement payment if the secretary determines that is required to protect the federal fiscal interest. When such an assignment is made, the agency may not retain any portion of collections. 34 C.F.R. 682.409(b).

overpayments and advances, and administering the program. 34 C.F.R. 682.410(a)(2)-(6).

b. A major problem with the GSLP has been the increasing accumulation and use of cash in the guaranty agencies' reserve funds. In a 1986 report commissioned by Congress, the Comptroller General found that state guaranty agencies had accumulated huge cash reserves that "exceed the risks guarant[y] agencies are asked to assume [at the] expense of the federal government and student borrowers." U.S. Government Accounting Office: *Better Criteria Needed for Financing Guarantee Agencies* 1 (1986). The Comptroller General also found that at least some agencies were using the reserves for improper purposes. *Id.* at 4. The Comptroller General recommended, among other things, that Congress set limits on the amount of cash guaranty agencies could retain in their reserve funds, to correspond to the actual financial risks they face. *Ibid.* The Comptroller General later submitted a report to Congress with draft guidelines for establishing maximum cash reserve levels. U.S. Government Accounting Office: *Guidelines for Reducing Guaranty Agency Reserves* (1986).

c. On December 22, 1987, Congress enacted the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the 1987 OBRA Amendments). Section 3001 of OBRA amended several GSLP provisions of the Higher Education Act of 1965. 20 U.S.C. 1072(e) (repealed).[3] Under Section 3002 of the 1987 OBRA Amendments, 101 Stat. 1330-38, the provisions of Section 3001 were scheduled to, and did, expire on September 30, 1989.

The 1987 OBRA Amendments required the Secretary to determine the "maximum cash reserve[ ]" permitted each

[3] In the legislative hisory of the OBRA, Section 3001 appears for the first time in the conference committee report. H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 39-41 (1987).

guaranty for fiscal year 1986 under a statutory formula based on the Comptroller General's draft guidelines. 20 U.S.C. 1072(e)(1) (repealed).[4] If the Secretary determined that any guaranty agency had, at the end of fiscal year 1986, cash reserves in excess of its "maximum," the Secretary was required to direct the agency to "eliminate" the excess by one or more of the following methods: (a) repaying advances of federal funds made by the Secretary to the agency and not otherwise required to be repaid; (b) withholding and canceling reimbursement claims otherwise payable by the Secretary to the agency; (c) reducing the amount of administrative cost allowances for which the agency otherwise would apply to the Secretary; and (d) any other method of reducing payments from, or increasing payments to, the federal government. 20 U.S.C. 1072(e)(2) (repealed). The 1987 OBRA Amendments also included provisions to enforce the transfer requirement. Those provisions made the state guaranty agencies' statutory "contractual right" to receive reimbursements and administrative cost allowances from the Secretary "subject to" the agencies' compliance with the transfer requirement. 20 U.S.C. 1078(c)(1)(A) and (f)(1)(B) (repealed).[5]

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[4] The maximum level was the greater of "(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year; (B) 0.3 percent of the original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year; (C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount; (D) $500,000; or (E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986." 20 U.S.C. 1072(e)(1) (repealed).

[5] Similarly, the 1987 Amendments made the amount of the reinsurance fee paid by agencies to the Secretary "subject to" the transfer requirement. 20 U.S.C. 1078(c)(9)(A) (repealed). That allowed agen-

The 1987 Amendments allowed the Secretary to waive the requirement to eliminate excess cash reserves if he determined that an agency's financial position had deteriorated significantly since the end of the preceding fiscal year, that significant changes in economic circumstances or the agency's loan insurance program rendered the maximum reserve level inadequate for the continued functioning of the agency, or that in eliminating the excess cash reserves the agency would violate contractual obligations on the date the 1987 OBRA Amendments were enacted requiring the agency to maintain a specific level of reserve funds. 20 U.S.C. 1072(e)(3) (repealed). The Amendments also set a nationwide limit of $250 million on the amount of excess cash reserves to be eliminated. 20 U.S.C. 1072(e)(4) (repealed).

All excess cash transferred to the Secretary by guaranty agencies under the 1987 Amendments was deposited in the GSLP student loan insurance fund maintained by the Secretary under 20 U.S.C. 1081. Pet. App. 4a. That fund is used to make reimbursement payments to guaranty agencies, as well as to make payments for defaulted loans insured directly by the Secretary. *Id.* at 4a-5a.

2. On the day the 1987 OBRA Amendments became effective, petitioner notified the Secretary that it considered them to abrogate the Secretary's contractual obligations, and that it would not comply with the transfer requirement. Pet. App. 6a. Petitioner also announced that it would no longer guarantee student loans, and it made arrangements for another agency to guarantee student loans in South Dakota. *Ibid.* The Secretary counseled petitioner against the steps it had taken, and he warned petitioner that its refusal to guarantee student loans consti-

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cies to increase the fee in satisfaction of that requirement. See 20 U.S.C. 1072(e)(2)(D) (repealed).

tuted a termination of the existing GSLP agreements and would end the Secretary's reinsurance commitment for loans guaranteed by petitioner on or after December 21, 1987. *Ibid.*

Meanwhile, as required by the 1987 OBRA Amendments, the Secretary calculated the statutory "maximum cash reserve" for petitioner. The Secretary concluded that petitioner had excess cash reserves, and directed petitioner to transfer most of that excess to the federal government.[6] Petitioner applied for, but was denied, a waiver of the transfer requirement. After petitioner continued to refuse to comply with the Secretary's directive, the Secretary withheld GSLP reimbursements otherwise payable to petitioner until the full amount of excess cash reserves owed was recovered. Pet. App. 7a.

Petitioner filed suit challenging the constitutionality of the 1987 OBRA Amendments and the Secretary's denial of a waiver. The district court upheld the Amendments and the Secretary's action, and the court of appeals affirmed.

On the constitutional issues, the court of appeals first held that the reserve fund "does not constitute property deserving protection of the fifth amendment's due process or taking clause." Pet. App. 17a.[7] Rather than deciding

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[6] Petitioner was required to transter $6,607,592 in excess cash reserves. Pet. 7. Petitioner had certified to the Secretary that it had cash reserves of $9,948,781, and the Secretary determined that petitioner's "maximum cash reserve" was $1,254,384. The amount of excess cash reserves petitioner was required to transfer was calculated by subtracting the "maximum" from the amount certified, further subtracting an amount owed to the Secretary under a different statute, and ratably reducing the result to comply with the $250 million nationwide ceiling on the recovery of excess cash reserves.

[7] The court of appeals initially addressed the waiver issue, because resoluion of that issue in petitioner's favor would have precluded consideration of the constitutional issues. Pet. App. 7a-8a. After reviewing the administrative record, the court held that the Secretary's denial

whether or to what extent petitioner had a property interest in the various and unsegregated sources of the reserve fund, the court of appeals examined the fund "as a whole," and found that it was "entirely a creature of federal regulation." *Ibid.* The court of appeals concluded from the purpose of petitioner and its reserve fund, from the understandings expressed in the GSLP agreements, and from the governing regulations, that petitioner had no protected Fifth Amendment interest in this fund. *Id.* at 18a-20a.

Next, the court of appeals held that the Secretary's implementation of the 1987 OBRA Amendments authorizing him to withhold reimbursements from non-complying guaranty agencies, such as petitioner, did not unconstitutionally abrogate petitioner's contractual rights. While the Amendments modified previous statutory language stating that guaranty agencies had a "contractual right" to reimbursements, by making that right "subject to" the agencies' compliance with the transfer requirement, the court of appeals pointed out that this "did not alter [petitioner's] preexisting legal rights" because petitioner's right to reimbursement "was always contingent on [petitioner's] compliance with federal law and regulations." Pet. App. 20a. Furthermore, the court of appeals noted that the guaranty agreements themselves authorized the Secretary to withhold reimbursements where, as here, petitioner failed to comply with an applicable law. *Id.* at 21a.

Finally, the court of appeals ruled that even if the Amendments authorizing the Secretary to withhold reimbursements were deemed to alter the terms of petitioner's guaranty agreements, they did not violate the Fifth Amendment. Pet. App. 21a-25a. Relying on *Bowen* v. *Agencies Opposed to Social Security Entrapment*, 477

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of a waiver was not arbitrary, capricious, or otherwise contrary to law. *Id.* at 8a-15a. The waiver issue is not presented in this petition.

U.S. 41 (1986), the court of appeals found that because the GSLP "is essentially a social welfare program designed to help the nation's youth gain access to higher education that they otherwise could not afford," and because the Higher Education Act "needs to be responsive to 'ever-changing' conditions," Congress implicitly reserved the right to impose additional requirements on guaranty agencies not contemplated when the guaranty agreements were signed. Pet. App. 22a-23a. While the court of appeals noted that Congress could not impose additional requirements that effectively nullified a contractual obligation, the conditioning of petitioner's receipt of reimbursements upon its compliance with the transfer requirement did not abrogate petitioner's contractual right to reimbursements, and merely "add[ed] to the numerous statutory and regulatory requirements with which * * * [petitioner] must comply" before it may receive reimbursements. *Id.* at 25a.

ARGUMENT

Petitioner has sought review of the court of appeals' judgment upholding the constitutionality of Section 3001 of the 1987 OBRA Amendments to the Higher Education Act of 1965. The questions presented in the petition are identical to the questions presented in *Maryland Higher Education Loan Corp.* v. *Cavazos*, No. 89-1873, *South Carolina State Education Assistance Auth.* v. *Cavazos*, No. 89-2027, and *North Carolina* v. *Cavazos*, No. 90-4, all of which seek review of the judgment of the Fourth Circuit upholding the constitutionality of Section 3001. Our consolidated brief in opposition in those cases (a copy of which has been provided to petitioner's counsel) fully

explains why review should not be granted in any of these cases.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[8] Since the filing of that brief, another court of appeals has joined the Fourth, Sixth, and Eighth Circuits in upholding Section 3001. *Great Lakes Higher Educ. Corp.* v. *Cavazos*, No. 89-2748 (7th Cir. Aug. 29, 1990). No court of appeals has ruled to the contrary.

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